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Japan's Stimulating Debate Over Economic Policy

Despite the strong recovery Japan has been enjoying for the past 18 months, Japanese policymakers have been locked in debate over one problem: how to sustain the rebound while reducing dependence on exports. The most obvious answer is to stimulate domestic demand. Prime Minister Yasuhiro Nakasone, however, has made fiscal austerity a hallmark of his administration, effectively removing increased deficit spending from Tokyo's arsenal of economic policies. This has led to a vigorous search for alternatives, specifically tax reform (see article this issue), deregulation and looser monetary policy.

• Tax fairness - MOF is proposing changes that would make it much more difficult for self-employed workers and farmers to conceal income. Tougher penalties are also being considered. The problems with this issue are political. Farmers and other self-employed workers are staunch supporters of the ruling Liberal Democratic Party (LDP). Some LDP members, however, advocate adopting the reforms in order to win the support of the increasingly important "salary man."

• Indirect taxes - In order to recoup the revenues lost through an income tax cut and to augment receipts, the introduction of a major new indirect tax is under consideration. A value-added tax, higher commodity taxes and a host of other consumption taxes have been suggested as options. Although a European-style value-added tax (which is applied at both the manufacturing and distribution stages) was originally the front runner, a tax on value added only during the production phase has gained ground. Such a tax is more politically palatable since the burden appears to fall only on the business sector. Of course, producers will almost certainly pass on the cost of the tax to consumers through higher prices.

• Tax preferences - The Japanese have recently heard a great deal of criticism about their high propensity to save. Multilateral organizations as well as individual countries have linked Japan's trade surpluses to its savings surplus. Officials respond that the country's high savings rate is a primary reason for the country's impressive economic growth in the postwar period. Other countries, they retort, do not save enough. Nevertheless, many Japanese analysts advocate tearing apart the web of savings incentives. Economic efficiency is best served, they feel, when saving and consumption decisions are made freely. They point out that Japan's consumer finance system is so underdeveloped and the population aging so rapidly that the average Japanese is not likely to change his thrifty ways any time soon. In addition, the revenue gained by eliminating the savings incentives could be applied to the national debt.

Mr. Nakasone, contemplating his chances of gaining a third term as prime minister, is pushing for the introduction of some reforms in fiscal 1986 -- leaving him less than nine months to hammer out a consensus. The debate will be heavily influenced by the results of the Finance Ministry study, which will in turn be heavily influenced by Mr. Nakasone. The political obstacles are daunting, however. As Mr. Reagan is discovering, a host of other issues can easily sidetrack any movement toward real tax reform.

Jon Choy

Japanese Foreign Direct Investment Continues To Boom

While U.S. direct investment abroad has been stuck in a slow-growth pattern since the start of the 1980s, Japanese foreign direct investment has taken off, jumping from a rather modest $31.8 billion in March 1980 to $71.4 billion five years later. In FY 1984 alone, Japanese corporations added a record-shattering $10.2 billion to their overseas equity holdings as all the factors executives weigh in considering foreign investment signaled go. Strong U.S. economic growth and improved market conditions in other areas of the world

Japan's Foreign Direct Investment by Country, FY 1980-FY 1984

(in millions of dollars)

	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	Total March 31, 1985
United States	$1,484	$2,354	$2,738	$2,565	$3,359	$19,894
Canada	112	167	167	136	184	1,575
North America	1,596	2,522	2,905	2,701	3,544	21,469
Panama	222	614	722	1,223	1,671	4,916
Brazil	170	316	322	410	318	4,274
Mexico	85	82	143	121	56	1,220
Peru	3	4	185	0	6	685
Bermuda	6	32	5	14	29	453
Latin America	588	1,181	1,503	1,878	2,290	13,020
Indonesia	529	2,434	410	374	374	8,015
Hong Kong	156	329	400	563	412	2,799
Singapore	140	266	180	322	225	1,930
Korea	35	73	103	129	107	1,548
Malaysia	146	31	83	140	142	1,046
Philippines	78	72	34	65	46	832
Thailand	33	31	94	72	119	711
Taiwan	47	54	55	103	65	647
Asia	1,186	3,338	1,384	1,847	1,628	18,027
Saudi Arabia/Kuwait	63	50	41	66	55	1,234
Iran	71	0	0	1	0	1,003
Saudi Arabia	15	45	57	90	43	357
Middle East	158	96	124	175	273	2,927
United Kingdom	186	110	176	153	318	2,766
Belgium-Luxembourg	77	211	191	391	386	1,575
West Germany	110	116	194	117	245	1,170
Netherlands	41	138	73	113	452	1,074
France	83	54	102	93	117	751
Switzerland	28	67	79	37	229	602
Spain	22	39	19	52	140	423
Europe	578	798	876	990	1,937	9,072
Liberia	110	466	434	323	281	2,296
Africa	139	573	489	364	326	3,198
Australia	431	348	370	166	105	3,153
Oceania	448	424	421	191	157	3,718
Total	4,693	8,931	7,703	8,145	10,155	71,431

Source: Ministry of Finance

Japan's Foreign Direct Investment by Industry, FY 1980-FY 1984

(in millions of dollars)

	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	Total March 31, 1985
Manufacturing Sector	$1,706	$2,305	$2,076	$2,588	$2,505	$22,048
Food Products	54	142	78	77	118	1,002
Textiles	91	91	67	174	85	2,055
Wood Products	78	65	76	91	115	1,106
Chemicals	314	228	322	450	223	3,849
Metals	493	521	468	479	718	4,805
Nonelectric Machinery	102	207	164	169	185	1,619
Electric Machinery	309	475	267	502	409	3,234
Transport Equipment	176	406	439	486	437	2,746
Other	89	169	195	160	215	1,633
Nonmanufacturing Sector	2,777	6,516	5,478	5,357	7,429	46,800
Agriculture/ Forestry	39	75	40	18	26	768
Fisheries	34	36	22	17	24	399
Mining	565	2,534	685	382	484	11,158
Construction	37	96	44	55	112	703
Trade/Sales	797	1,174	1,899	1,164	1,482	11,128
Banking/Finance/ Insurance	380	843	533	1,167	2,085	7,054
Services	926	623	702	622	681	4,021
Transportation		722	924	1,363	1,651	4,660
Real Estate		167	354	375	430	1,326
Other		246	276	193	454	5,583
Branch Offices	119	110	149	200	221	1,989
Real Estate Transactions*	91	---	---	---	---	595
Total	4,693	8,931	7,703	8,145	10,155	71,431

*Overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980 because of changes in the Foreign Exchange and Foreign Trade Control Law.

Source: Ministry of Finance

exerted an enormous pull on Japanese businesses, regardless of their field. Higher corporate earnings and narrowing investment opportunities at home provided an equally big push; so did the continued appreciation of the yen through the summer of 1984. In addition, the spreading threat of protectionism in the United States and Europe gave Japanese manufacturers an extra incentive to invest in offshore production facilities.

The United States remained the prime location for Japanese foreign direct investment in FY 1984, attracting an all-time-high $3.4 billion (see accompanying table). In a repeat of the April 1983-March 1984 period, Japanese companies earmarked roughly $1 billion for the construction or acquisition of U.S. production facilities. Most of this money again went into factories to manufacture metals and fabricated metal products, industrial and consumer electronics products, automotive equipment and chemicals, with Nippon Kokan K.K.'s purchase of a 50 percent interest in National Steel Corp. for $273 million representing the largest manufacturing investment of the fiscal year. Japanese corporations also continued to expand their foothold in the American banking, finance and insurance sector, investing an estimated $0.6 billion; half of this amount underwrote the acquisition of BanCal Tri-State Corp., the holding company for California's eighth largest bank, by Mitsubishi Bank, Ltd. Another $0.6 billion or so was channeled into the U.S. sales organizations of Japanese companies.

Japanese businesses also added a record $1.9 billion to their European holdings during the year ending in March 1985. Financial institutions were the major investors here, putting $1 billion into banking, finance and insurance subsidiaries and affiliates. More money was invested in production facilities, but the $0.3 billion addition paled in comparison with the amount going into the U.S. manufacturing sector. Europe and the United States were on a more equal footing when it came to the expansion of commercial enterprises since Japanese distributors invested $0.4 billion in European sales organizations.

While stepped-up activity in the United States and Europe was the main impetus behind the big jump in Japanese foreign direct investment in FY 1984, a large volume of capital continued to flow into the economies of Latin America and Asia. Japanese investment in Latin America, in fact, set a new record of $2.3 billion. The transportation industry remained the region's major magnet, attracting $1.3 billion in funds, although $0.3 billion did go into the manufacturing sector. Japanese corporations pursued a more diversified investment strategy in Asia. One-third of the $1.6 billion invested in this area during the April 1984-March 1985 period went into production facilities, with most of the rest divided among the services, financial and mining industries.

The huge flow of funds going into the United States during FY 1984 reinforced North America's position as the top location for Japanese foreign direct investment. As of this past March, corporate investors had a $21.5 billion stake in the United States and Canada. Sales offices still accounted for the biggest block of money -- $6.6 billion-plus, but there was ample evidence of the evolving investment strategy of Japanese businesses. One indication was the $6.5 billion invested in the manufacturing sector, an amount split almost evenly between the electronics, transportation equipment and metals industries and other industries. Another sign was the $2.7 billion that had gone into the banking, finance and insurance sector.

Asia, the leading overseas investment site for Japanese corporations through March 1983, held onto the number-two spot in FY 1984 despite the upsurge in activity in Latin America and Europe. Out of the $18 billion that had been invested in this region, $7.1 billion was in metals, chemicals, textiles and other manufacturing operations and $5.9 billion in mining. Trailing Asia was Latin America, where Japanese firms had equity holdings of $13 billion, concentrated in production facilities ($4.2 billion), especially steel and nonferrous metals, and transportation services ($3.5 billion).

With $2.5 billion going into offshore factories during the April 1984-March 1985 period, the manufacturing sector continued to represent the leading edge of Japanese direct investment activity (see accompanying table). By the end of the fiscal year, Japanese corporations had funneled nearly $22.1 billion into manufacturing plants abroad, including $7.1 billion in Asia, $6.5 billion in North America and $4.2 billion in Latin America. Mining projects and sales operations remained a distant second to manufacturing facilities as the destination for Japanese foreign investment funds. Just over $11.1 billion had been invested in mining through this past March, divided between Asian countries, mainly Indonesia, and the rest of the world, while an equal amount had gone into the commercial sector, with three-fifths in American and Canadian sales subsidiaries and affiliates. The fourth-largest concentration of money -- $7.1 billion worth -- was in overseas banking, finance and insurance organizations, anchored by investments of $2.7 billion in both North America and Europe.

Susan MacKnight

Court Rules Election Unconstitutional; Electoral Reform Pressures Mount

On July 17 Japan's Supreme Court ruled unconstitutional the results of the December 1983 lower house election because of the Diet's failure to reapportion election districts to reflect shifts in the voting population. The decision will not affect the actual election results or actions taken by Diet members elected in 1983; the court noted that overturning the results simply would be impractical. It does increase pressure on the Nakasone government to enact legislation to eliminate disparities in the relative representational strength of lower house districts.

The court ruling came in response to superior court decisions originating in 21 election districts throughout the country -- the majority in the Tokyo metropolitan area. Petitioners claimed that the election results were not constitutional because urban areas are significantly under-represented in lower house election districts. The court agreed, reaffirming a position similar to its 1976 ruling that cast doubts on the constitutionality of lower house elections held four years earlier.

In Japan's treatment of constitutional issues, "unconstitutional" does not necessarily mean invalid. Hence the election results, although determined to have violated voters' constitutional rights to equal representation, were not overturned altogether. However, it is doubtful whether the lower house could be dissolved -- a step that is tantamount to calling for elections -- before instituting some type of reform. Several justices said in individual

Japanese Investment in U.S. Automotive Assembly Facilities

Parent	Subsidiary	Location	Product Line	Annual Capacity	Employment	Investment	Start Date
Honda Motor Co., Ltd.	Honda of America Manufacturing, Inc.	Marysville, OH	Compact cars Subcompact cars	150,000 (current) 300,000 (1988)	2,500 (current) 3,000 (1988)	$490 million	November 1982 Mid-1986
Nissan Motor Co., Ltd.	Nissan Motor Manufacturing Corp. U.S.A.	Smyrna, TN	Compact pickups Subcompact cars	180,000 (current) 240,000 (spring 1987)	3,000	$585 million	June 1983 March 1985
Toyota Motor Corp. General Motors Corp.	New United Motor Manufacturing Inc.	Fremont, CA	Subcompact cars	100,000 (current) 200,000 (early 1986)	1,500 (current) 2,500 (early 1986)	$400 million	December 1984
Mazda Motor Corp.	Mazda Motor Manufacturing (USA) Corp.	Flat Rock, MI	Compact cars	240,000 (fall 1988)	3,500 (fall 1988)	$450 million (estimated)	Fall 1987
Mitsubishi Motor Corp. Chrysler Corp.	Undecided	Undecided	Subcompact cars	180,000 (1990)	2,500 (1990)	$500 million (estimated)	Fall 1988
Toyota Motor Corp.	Undecided	Undecided	Compact cars	200,000	Undecided	Undecided	1988